

AR79

Canadian Cellulose Company, Limited

1977 ANNUAL REPORT





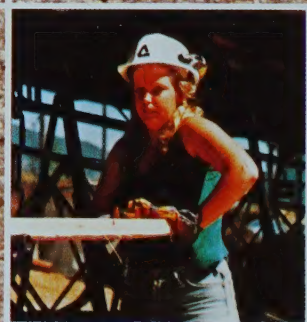
Cover and Inside Cover:
The renewable forests under Canadian Cellulose management are harvested on a sustained yield basis and nature is assisted in reforestation of cutover lands to ensure a perpetual supply of wood fibre for the company's lumber and pulp operations.

The Company

Canadian Cellulose is a British Columbia-based forest products company employing nearly 2,500 persons in its pulp and lumber manufacturing and logging operations. These facilities are located in the north-western and southern interior regions of the province. Pulp marketing offices are located in Brussels, Montreal and at the corporate offices in Vancouver.

The company operates two bleached softwood kraft pulp mills, three lumber mills and two logging divisions. Additional kraft capacity and a new smallwood sawmill will come on stream in 1978. Productive forest lands under management encompass more than 2.8 million acres in the province.

Export sales account for 90 percent of sales revenue. Bleached softwood kraft pulp is the company's major product and is marketed, largely on a long term basis, in more than 20 countries. Lumber is sold mainly in North America.



Annual General Meeting

April 21, 1978, 10:00 a.m.
Social Suite West
Hotel Vancouver, Vancouver, B.C.

Index

Highlights	1
Letter to Shareholders and Employees	3
Financial Section	
Financial Review	8
Variance Analysis	8
Summary by Quarter	9
Earnings Statement	11
Balance Sheet	12
Changes in Financial Position	14
Notes to Financial Statements	15
Auditors' Report	17
Five Year Review	18
Five Years at a Glance	19
Corporate Information	23

Highlights

	1977	1976
Earnings		
Earnings before taxes and extraordinary item	23,502,000	29,445,000
Earnings before extraordinary item	12,552,000	14,595,000
Net earnings	17,252,000	26,145,000
Per share		
Earnings before extraordinary item	\$ 1.03	1.20
Net earnings	1.41	2.14
Cash flow from operations	2.68	3.06
Shareholders' equity (book value)	9.71	8.62
Dividends	32¢	30½¢
Financial position at end of year		
Working capital	\$ 57,134,000	65,339,000
Total assets	247,931,000	182,894,000
Long term debt	79,456,000	41,215,000
Shareholders' equity	118,504,000	105,137,000
Analytical information		
Percent return on net sales	7.8%	8.2%
Percent return on net capital employed	6.9%	10.9%
Ratio of current assets to current liabilities	2.3:1	2.8:1
Long term debt as a percent of total capital	39.2%	28.1%
Additional information		
Expenditures on fixed assets	\$ 77,873,000	27,494,000
Depreciation, amortization and depletion	11,675,000	11,335,000
Wages, salaries and employee benefits	54,300,000	56,200,000
Number of employees at end of year	2,491	2,631
Number of registered shareholders at end of year	5,293	5,596
Note: These Highlights and the letter to Shareholders and Employees constitute the Directors' Report to the members for the year 1977.		



Donald N. Watson

Ronald M. Gross

Scheduled for completion in 1978 is the sulphite-to-kraft modification project at Prince Rupert.

To Our Shareholders and Employees:

Record lumber performance and currency exchange gains had a favourable impact on results.

The company made substantial and satisfactory progress in 1977 despite changing international market conditions.

A record performance in the company's lumber sector and exchange gains resulting from the lower value of the Canadian dollar compared to United States currency were major factors having a favourable impact on results for the year. These were more than offset by a significant decline in the worldwide price of bleached softwood kraft pulp which affected pulp earnings. However, the company's sales and earnings were only moderately lower than in 1976.

Earnings before an extraordinary tax credit were \$12.6 million or \$1.03 per share compared to \$14.6 million or \$1.20 per share in 1976. Net earnings after the tax credit were \$17.3 million or \$1.41 per share compared to the previous year's \$26.1 million or \$2.14 per share. Net sales for 1977 were \$161.1 million compared to \$177.6 million in 1976.

Although the U.S. economy maintained a slow but steady growth during the year, an expected recovery of the European and Japanese economies did not materialize. World markets for wood pulp, which accounts for two-thirds of the company's sales, reflected the flat economic conditions that persisted throughout the year.

World inventories of wood pulp at the manufacturing level increased throughout 1977 to nearly 2.9 million metric tonnes by the third quarter before declining to 2.2 million tonnes by year-end. The reduced level was still substantially above the 1.2 million tonnes which is generally considered a more normal inventory level for North American and Scandinavian producers.

Despite the inventory build-up in the first half, the world price for premium fully bleached softwood kraft pulp held reasonably firm until midyear. From that time to December, however, competitive pressures reduced the world softwood kraft price, which had not been increased since January, 1975, by approximately \$85 per tonne.

Notwithstanding these severe market conditions, our kraft pulp shipments continued at virtually the same level as during the previous year. This achievement reflects the long term relationships we have built and maintained with our customers. Although shipments were maintained, production at our two kraft mills was reduced to 319,000 tonnes from 365,000 tonnes.

The Castlegar mill operated at close to 90 percent of rated capacity for the year while the Prince Rupert mill ran at just over 65 percent. Prince Rupert production was affected by a shortage of chemicals due to a strike in the chemical industry early in the year and by an extended shutdown in the fall to effect tie-ins required for the sulphite-to-kraft modification project.

Cost reduction measures were intensified at both pulp manufacturing operations although temporarily higher unit costs were experienced at Prince Rupert as production at the continuing kraft mill bore the full costs of common facilities that will be serving two mills upon completion of the modification program. Significant results have been achieved thus far in energy conservation with a consequent reduction in costs of purchased fuels. Efforts continue to further improve the efficiency of the mills' waste wood burning capacities.

The Prince Rupert sulphite modification project continues on schedule toward a phased-in start-up commencing in June. Full operation is planned for October, at which time kraft pulp capacity at Prince Rupert will increase to approximately 1100 tonnes per day from the current 680 tonnes per day. We believe this increased output of highest quality product will be achieved at lower unit costs than are now in effect.

Kraft pulp prices dropped by \$85 per tonne but shipments continued at virtually the same level as the previous year.

Increased pulp production will be achieved at lower unit cost.

**New smallwood sawmill will boost
lumber production and improve
wood utilization.**

Our lumber business turned in a record performance in 1977 on the strength of construction activity in the United States. The demand for lumber in the U.S. was spurred by an increase in housing starts to an annual level approaching two million units, combined with generally increased industrial and commercial construction. The company's three sawmills produced a total of 258 million board feet of lumber compared to 250 million board feet in 1976.

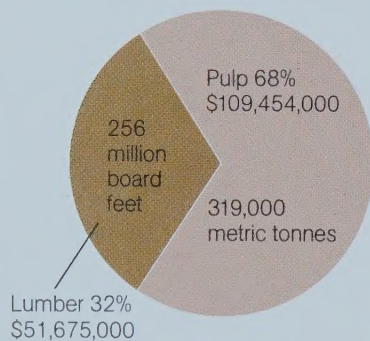
In line with the company's goal to achieve the highest value utilization of the available wood supply, a new smallwood sawmill is currently under construction at Castlegar. The mill will start-up in April, 1978, with an annual capacity of 30 million board feet of planed kiln-dried lumber. About 58,000 cunits of logs from four-inch tops to 12-inch butts will be used annually for the mill.

Logging operations in the north-western and southern interior regions of the province, where the company's two tree farm licences are located, produced a total of 802,000 cunits of logs (a cunit is 100 cubic feet of solid wood) compared to 831,000 cunits in 1976. Reduced production was necessary to improve the inventory balance of sawlogs compared to pulplogs and also reflected reduced log requirements.

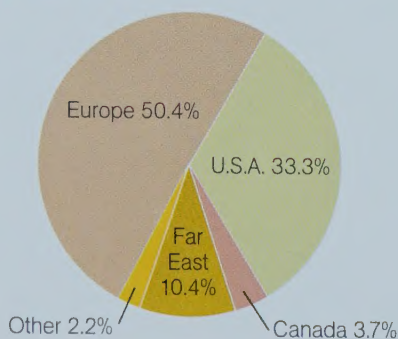
**Employee performance was a
source of particular satisfaction
in 1977.**

Employee performance in all operations was a source of particular satisfaction in 1977 as the challenge of a difficult year was met in many ways. Safety performance continued to improve over the preceding year and the overall frequency and severity of lost-time accidents was further reduced. At Prince Rupert, the mill's safety record was one of the three best in the province during the third and fourth quarters. This achievement is particularly noteworthy in view of the concurrent construction of new facilities, demolition of the now obsolete sulphite plant and operation of the existing kraft mill. Overall turnover rates were further decreased from previous years which has led to improved productivity. A cooperative approach to labour-management relations within the respective divisions was continued with positive results. Two-year collective agreements were negotiated on an industry-wide basis with unions representing the company's woods, lumber and pulp employees.

Sales by major products—1977



**Pulp sales revenues by
market area—1977**



B.C. Hydro has now received approval of a plan to construct a major hydro-electric dam on the Columbia River near Revelstoke. Logs harvested from the company's tree farm licence in this region are now transported by water to the converting mills at Castlegar, a distance of more than 150 miles. We are continuing efforts in appeal proceedings to safeguard the company's rights to use the waterway, and to be compensated for additional costs incurred as a result of the dam.

Babine Forest Products Limited, in which we have a 24 percent interest, continues to operate profitably and paid an increased dividend. During the year the company sold, at a modest gain, its investment in Haseldonckx, S.A., a Belgian paper convertor.

During the year, provincial legislation was enacted providing for the creation of the British Columbia Resources Investment Corporation. The legislation enables the Province to transfer the shares it holds in Canadian Cellulose, in addition to other specified assets, to the new corporation, which will not be a Crown Corporation.

With the retirement of Donald P. Best, Senior Vice President, Operations, the executive management structure was re-organized in terms of the company's product business sectors. Herschell F. Huff was appointed Senior Vice

President, Pulp and Gordon R. McLachlin, Senior Vice President, Logging and Lumber. Roy W. Murphy assumed added corporate responsibility as Senior Vice President, Administration.

The Board announced, on December 19th, 1977, that Ronald M. Gross was resigning as an officer of the company effective March 1st, 1978, to become President and Chief Operating Officer of ITT Rayonier at its international corporate office in New York.

Mr. Gross has been a senior executive of Canadian Cellulose and its predecessor company since 1968. In making the announcement, the Board recorded its gratitude and appreciation for his outstanding contribution to the company, being largely responsible for its re-organization in 1973 and providing excellent leadership during the subsequent period of strong financial recovery.

The Board also announced the appointment of Donald N. Watson as President and Chief Executive Officer to succeed Mr. Gross. Mr. Watson has been a director since the re-organization and has been Chairman of the Board since July, 1976. He will continue as Chairman. The Board noted that Mr. Watson's close association with the company and his extensive experience as a chief executive officer in British Columbia will provide Canadian Cellulose with continuity of strong management and leadership.

Five year Review

Year-to-year comparisons do not always provide a complete picture of the progress of an organization. It is useful periodically to examine its results over a longer period so as to gain a better perspective of the various factors influencing performance.

When the company was re-organized nearly five years ago, the Board of Directors and management identified a number of challenges and opportunities. These included development of a more appropriate pulp marketing strategy, improvement in financial condition, resolution of the problems of an obsolete sulphite mill, improvement in wood resource utilization and development of a long term environmental program.

We believe the company has made significant progress during the five year period in all of these areas. Long term relationships have been developed with our pulp customers. The company's financial condition has improved substantially. We regard our business as one of long term cash flow and since the re-organization in 1973, this has amounted to \$183 million. Our capital investments for this period, all of which were made in British Columbia, were nearly \$140 million. Working capital has been maintained at an adequate level and our total assets have grown from \$107 million to \$248 million.

Long term debt as a percentage of total capital employed was reduced from 97 percent to 39 percent, while book value per share increased from 16 cents to \$9.71 over the five year period.

Significant progress achieved on challenges and opportunities identified at time of re-organization in 1973.

Long term relationships developed with pulp customers; financial condition improved.

New debt negotiated and existing debt re-organized on unsecured basis.

In 1976, the company negotiated a new issue of \$70 million unsecured 15-year promissory notes and re-organized its total existing debt on an unsecured basis. Together with internal capital, this additional financing has provided the necessary capital for the modification project. The series of drawdowns commenced in August, 1977 with final receipts scheduled for mid-June, 1978.

A conscientious operating objective has been to provide and maintain modern and efficient facilities and we are well along with this program. Emphasis has been given to capital reinvestment for productivity improvement and cost effectiveness. In addition, the company has also recognized its responsibility to use its best efforts to comply with applicable environmental requirements.

The modification program at Prince Rupert as well as the past five year capital program, when completed at the end of 1978, will place the company among the most competitive and cost efficient in Canada in both pulp and lumber.

Outlook

While it is extremely difficult to assess general economic and pulp market conditions, particularly for the second half of 1978, we do expect that world prices for softwood kraft pulp are now either at, or very close to the bottom of the market cycle. We do not foresee a significant price recovery during the year. It is likely that there will be some firming of pulp demand compared to supply by the end of the fourth quarter.

The outlook for lumber is encouraging for the year. Construction activity in the United States remains buoyant although we do anticipate a moderate decline in housing starts toward the second half of the year.

Our course is fairly well set for 1978. The year will see the completion of our two significant capital projects, the pulp modification program at Prince Rupert and the smallwood sawmill at Castlegar. We are now working to ensure successful start-ups of these facilities.

Environment

With regard to the environment, effective pollution abatement measures require long term planning approaches in view of the substantial capital expenditures involved and the changing state of proven, economically viable technology.

It is essential that full consideration be given to the basic financial ability of a company to undertake major environmental programs when it must also provide for continued plant maintenance and growth investment to remain economically competitive. In this context, a proper balance of social and economic objectives must be found that are consistent with basic corporate responsibilities.

It is fundamental that close working relationships be established and maintained with federal and provincial regulatory and technical agencies. In 1978, the company and the forest products industry will continue to be actively engaged in discussions with appropriate agencies regarding a balanced and long term approach to the preservation of the environment.

Pulp demand should firm by year-end and lumber outlook is encouraging.

Effective pollution control requires long term planning and consideration of basic financial ability.

**National economic policy need
being recognized.**

National Responsibility and Opportunity

We are encouraged by a growing recognition on the part of the public and particularly by government of the vital need for a national economic policy which transcends regional aspirations.

The export orientation of Canada, with its absolute need to compete effectively in world markets, has long been articulated by the forest industry. The country is now faced with the added task of meeting increased foreign competition in domestic markets and of generating capital investment for Canadian industrial growth.

As the nation is about to enter the critical decontrol phase, faced with continued high rates of inflation and rising unemployment, the need for cooperation, restraint and maturity of the major partners in the economy is both real and compelling.

We are confident that the commitments necessary to maintain a national economy that will at least parallel the growth rates of Canada's major trading partners will be made.

We also are optimistic about Canadian Cellulose's future and the contribution the company can make as we work further toward our broad corporate objective of maximizing the company's long term value to our shareholders, employees, customers and to society. We believe that the necessary, substantial steps have now been taken to enable the company to fully participate in world markets as a major forest products producer.

On behalf of the Board of Directors,



Donald N. Watson,
Chairman



Ronald M. Gross,
*President and Chief
Executive Officer*

*Vancouver, B.C.
February 21, 1978*

Financial Review

Canadian Cellulose Company, Limited and subsidiaries

Net earnings after tax but before an extraordinary credit for 1977 were \$12.6 million, or \$1.03 per share, compared to \$14.6 million in 1976 or \$1.20 per share. The earnings decline of 14 percent is largely attributable to lower kraft pulp prices and higher manufacturing costs partly offset by favourable foreign exchange effects, a fire insurance claim and higher lumber prices. With approximately 90 percent of sales in United States dollars, the lower value of the Canadian dollar had the effect of contributing to after tax earnings approximately \$6.5 million or 53 cents per share, as compared to 1976.

Net sales were \$161.1 million compared to \$177.6 million last year, a decrease of \$16.5 million or 9.3 percent. The lower sales reflected reduced sulphite pulp sales volumes as a result of the closure of the mill in October, 1976 and lower prices for kraft pulp. These factors were partially offset by the favourable U. S. dollar rate of exchange, higher lumber shipments of approximately three percent, and lumber prices that averaged 16 percent higher than in 1976.

Other income totalling \$6.2 million increased \$4.6 million over the previous year. The increase was due primarily to the payment of insurance proceeds, net of cost, of pulp destroyed by fire.

Cost of goods sold decreased by \$7.0 million as a result of the lower volume of sulphite pulp sales. However, cost of goods sold as a percent of net sales increased from 79.3 percent to 83.1 percent primarily due to lower kraft pulp prices and increased manufacturing costs. Chemical prices increased by nine percent, natural gas by 31 percent, labour by 10 percent and wood, seven percent. In addition, lower production levels at the Prince Rupert kraft mill due to plant closures to effect tie-ins required for the sulphite modification project, and as a result of a chemical shortage early in the year, also affected adversely profit margins.

Selling and administration expenses increased \$1.0 million over 1976 primarily due to general inflationary pressures and increased selling expenses as a result of higher volume shipments overseas. As a percentage of net sales, selling and administration costs were four percent in 1977 compared to three percent in 1976.

Income taxes — The effective tax rate on earnings was 46.6 percent for 1977 compared to 50.4 percent in 1976. The lower rate was due largely to the three percent federal tax credit for inflation on inventory values. Income taxes on current year's earnings totalled \$10.9 million. This cost is reduced by the income tax reduction on application of prior years' losses of \$4.7 million. An additional \$4.9 million is deferred due to application of accelerated capital cost allowances arising out of our large capital expenditure program. The net taxes payable, \$1.3 million, relates to logging taxes for which the company receives no income tax offsets, a form of double taxation.

Capital program — Capital expenditures were \$77.9 million, comprising \$63.4 million on the sulphite modification project at Prince Rupert, \$5.3 million to maintain and modernize existing facilities, \$2.9 million for pollution control and environmental protection, \$4.5 million to develop new logging roads, and \$1.8 million on the new smallwood sawmill at Castlegar. The project at Prince Rupert continues on schedule for start-up in the fall of 1978. Capital expenditures for 1978 are estimated at \$71.0 million. Included in the 1978 program is \$52.0 million on the sulphite modification project at Prince Rupert and \$5.7 million on the smallwood sawmill at Castlegar. The balance will be spent on logging roads and to maintain and modernize existing facilities.

Variance Analysis

Change in earnings per share:	1977 vs. 1976
Current year	\$1.03
Prior year	1.20
Decrease	\$ (.17)
Analysis of increase (decrease):	
Operations—	
Selling prices after foreign exchange	
—Kraft pulp	\$ (.43)
—Lumber	.41
Northern pulp mill—higher unit costs resulting from lower kraft pulp production levels and general inflation	(.28)
Fibre and chemical costs	(.10)
All other operating costs	(.03)
	(.43)
Other Causes—	
Fire insurance claim	.19
Equity in income of affiliate and gain on sale of investment	.07
Income taxes	.07
All others	(.07)
	.26
Net increase (decrease)	\$ (.17)

Financial position — Funds generated from operations totalled \$32.7 million compared to \$37.3 million in 1976. The reduction was due to lower earnings. We reported at the end of 1976 that the company had agreed, subject to completion of formal documentation, to issue Promissory Notes aggregating U. S. \$50.0 million and Cdn. \$20.0 million. The formal documentation was completed and U. S. and Canadian dollars totalling \$42.0 million were drawn down in 1977.

Total proceeds from the drawdowns after conversion of the U. S. dollars was \$44.4 million. The remaining funds, \$28.0 million in U. S. and Canadian currencies, are due to be drawn down by mid-1978.

Total sources of funds amounted to \$80.2 million. The application of funds totalled \$88.4 million of which \$77.9 million related to the capital expenditure program, \$6.5 million for long term debt repayment and \$3.9 million for dividends. The excess of funds expended over total sources was \$8.2 million, reducing the working capital from \$65.3 million to \$57.1 million. The working capital ratio at December 31, 1977 was 2.3:1, compared to 2.8:1 at the end of 1976.

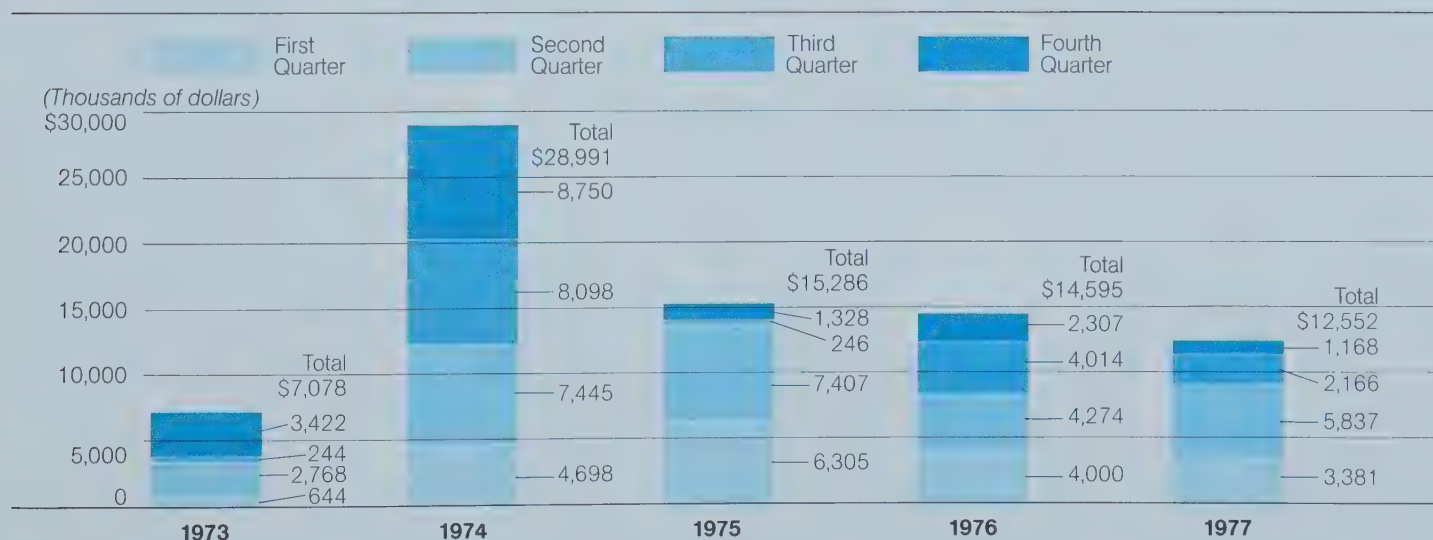
The long term debt drawdowns resulted in long term debt (net of repayments) increasing from \$41.2 million to \$79.5 million, giving rise to an increase in the percentage of long term debt to total capital employed from 28 percent to 39 percent.

Net earnings were \$1.41 per share and dividends 32 cents per share. The remaining \$1.09 per share was retained in the business and increased the book value per share from \$8.62 to \$9.71.

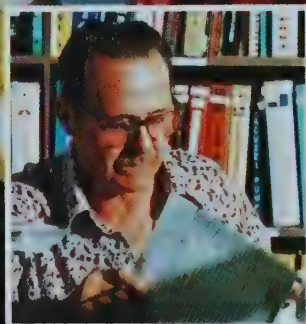
1977 Summary by Quarter

(Thousands of dollars)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year 1977
Net sales	\$41,053	41,481	36,999	41,596	161,129
Earnings before taxes and extraordinary item	6,631	11,447	3,646	1,778	23,502
Provision for income taxes	3,250	5,610	1,480	610	10,950
Earnings before extraordinary item	3,381	5,837	2,166	1,168	12,552
Extraordinary item	850	850	850	2,150	4,700
Net earnings	\$ 4,231	6,687	3,016	3,318	17,252
Per share					
Earnings before extraordinary item	\$.28	.48	.17	.10	1.03
Net earnings	\$.35	.55	.24	.27	1.41

Five year comparison of earnings before extraordinary item, by quarter



Some of our 2,500 employees
whose efforts have contributed
substantially to the company's
success.



Consolidated Statement of Earnings

Canadian Cellulose Company, Limited and subsidiaries

<i>(Thousands of dollars)</i>	1977	1976
Revenues		
Net sales	\$161,129	177,612
Other income (note 10)	6,162	1,591
	167,291	179,203
Cost and expenses		
Cost of goods sold	133,856	140,834
Selling and administration	6,402	5,398
Long term debt interest	2,683	2,857
Other	848	669
	143,789	149,758
Earnings before taxes and extraordinary item	23,502	29,445
Provision for income taxes	10,950	14,850
Earnings before extraordinary item	12,552	14,595
Income tax reduction on application of prior years' losses (note 4)	4,700	11,550
Net earnings	\$ 17,252	26,145
Per share		
Earnings before extraordinary item	\$ 1.03	1.20
Extraordinary item	.38	.94
Net earnings	1.41	2.14

Consolidated Statement of Retained Earnings

Retained earnings at beginning of year	\$ 36,365	13,939
Net earnings for the year	17,252	26,145
	53,617	40,084
Dividends — 32¢ per share (30.5¢ per share in 1976)	3,902	3,719
Retained earnings at end of year	\$ 49,715	36,365

Consolidated Balance Sheet at December 31

Canadian Cellulose Company, Limited and subsidiaries

Assets

<i>(Thousands of dollars)</i>	1977	1976
Current assets		
Short term investments	\$ —	5,145
Accounts receivable	35,360	26,181
Inventories (note 2)	65,917	69,973
Prepaid expenses	837	461
	102,114	101,760
Investments in and advances to associated companies	1,540	3,231
Timber deposits and other investments	1,544	1,070
Property, plant and equipment (note 3)	142,733	76,833
	\$247,931	182,894

Liabilities

	1977	1976
Current liabilities		
Bank indebtedness	\$ 8,457	4,177
Accounts payable and accrued liabilities	27,069	23,018
Income taxes (note 4)	2,341	2,658
Current portion of long term debt	7,113	6,568
	44,980	36,421
Long term debt (note 5)		
Bonds	34,438	40,926
Promissory notes	44,387	—
Other	-631	289
	79,456	41,215
Deferred income taxes (note 4)	4,991	121
Shareholders' Equity		
Share capital (note 7)	68,789	68,772
Retained earnings (note 8)	49,715	36,365
	118,504	105,137
	\$247,931	182,894

Approved by the Board of Directors:

 Director

Director

 Director

Director

Consolidated Statement of Changes in Financial Position

Canadian Cellulose Company, Limited and subsidiaries

<i>(Thousands of dollars)</i>	1977	1976
Source of funds		
From operations		
Earnings before extraordinary item	\$12,552	14,595
Charges to earnings not involving use of funds		
Depreciation, amortization and depletion	11,675	11,335
Deferred income taxes	4,870	—
Other	(1,110)	(159)
	27,987	25,771
Income tax reduction on application of prior years' losses	4,700	11,550
	32,687	37,321
Sale of fixed assets	402	101
Sale of investment in associated company	2,671	—
Issue of Common Shares	17	22
Issue of long term debt (note 5)	44,387	—
	80,164	37,444
Application of funds		
Expenditures on fixed assets	77,873	27,494
Dividends	3,902	3,719
Reduction of long term debt	6,488	6,489
Other	106	(24)
	88,369	37,678
Decrease in working capital	8,205	234
Working capital at beginning of year	65,339	65,573
Working capital at end of year	\$57,134	65,339

Notes to the Consolidated Financial Statements

Canadian Cellulose Company, Limited and subsidiaries

1. Summary of significant accounting policies

(a) Consolidation

The consolidated financial statements include the accounts of the company and its subsidiaries, all of which are wholly-owned.

(b) Investments in associated companies

The investment in Babine Forest Products Limited (24% owned) is accounted for on the equity method. The investment in Haseldonckx, S.A., formerly 50% owned and accounted for on the equity method, was sold in 1977; the gain is reflected in other income.

(c) Translation of foreign currencies

Where covered by forward exchange contracts, current assets and current liabilities in foreign currencies are translated into Canadian dollars at the related contract rates. Where not so covered, current assets and current liabilities are translated at exchange rates prevailing at the end of each year. Long term debt is translated at rates the funds were converted into Canadian dollars except that the Bonds have been translated at the rate of exchange prevailing on the date of the June 29, 1973 re-organization. Revenues and expenses of foreign subsidiaries are translated at average exchange rates for each year.

(d) Inventories

Logs, pulp chips and other raw materials are valued at the lower of average cost and replacement cost. Finished products (pulp and lumber) are valued at the lower of average cost and net realizable value. Supplies are valued at average cost.

(e) Property, plant and equipment

These assets are stated at cost. When such assets, except logging equipment, are disposed of in the normal course of business, the cost is removed from the asset accounts and charged to the accumulated depreciation account and the proceeds are credited to the accumulated depreciation account. When logging equipment is disposed of, the cost and related accumulated depreciation are removed from the accounts and any gain or loss is reflected in earnings.

(f) Depreciation, amortization and depletion

Depreciation, amortization and depletion are computed on original cost as follows:

Asset	Method
Pulp mills	4% composite rate; straight-line
Sawmills	4% to 6% composite rate; straight-line
Logging equipment	10% to 20% rate; diminishing balance
Timber cutting rights, roads and related facilities	units of production method, using current log production as a percentage of estimated total log production available from such assets

2. Inventories

<i>(Thousands of dollars)</i>	1977	1976
Logs, pulp chips and other raw materials	\$ 32,496	25,932
Pulp and lumber	26,521	37,377
Supplies	6,900	6,664
	\$ 65,917	69,973

3. Property, plant and equipment

<i>(Thousands of dollars)</i>	1977	1976
Pulp mills	\$178,023	173,044
Sulphite mill modification in progress	81,451	18,083
Sawmills	23,620	21,296
Timber cutting rights, roads and related facilities	43,660	39,372
Logging equipment and other facilities	19,858	19,524
Land	971	955
	347,583	272,274
Less: Accumulated depreciation, amortization and depletion	204,850	195,441
	\$142,733	76,833

As a result of the June 29, 1973 re-organization, property, plant and equipment was written down by \$75,485,000, of which \$9,964,000 was applied against the net book value of specific assets and \$65,521,000 was added to accumulated depreciation, amortization and depletion.

4. Income taxes

In certain prior years, the company incurred cash losses and recorded in its accounts depreciation, including extraordinary write-downs of fixed assets, in excess of the amounts which it claimed for income tax purposes. The resulting potential tax benefits were not recognized in the accounts of those years because of the uncertainty of their ultimate realization but were recognized in later years to the extent realized. In 1977, the remaining benefit of \$4,700,000 has been recorded as the company will claim for tax purposes the remainder of such prior years' losses and depreciation charges. The company will also claim in 1977 additional depreciation for tax purposes in excess of that charged in the 1977 accounts and the resulting deferred income taxes are reflected on the balance sheet.

Since June, 1975 the company has made fixed asset acquisitions qualifying for federal investment tax credits which would enable it to reduce income tax expense by approximately \$3,000,000 if substantial income taxes become payable prior to December 31, 1982. The company does not intend to record such benefits in its accounts until it is virtually certain that the investment tax credits will be realized.

5. Long term debt

<i>(Thousands of dollars)</i>	1977	1976
Bonds, excluding the portion payable within one year which is included in current liabilities:		
6½% Bonds due January 2, 1981 with annual sinking fund instalments (1977 U.S. \$12,000,000; 1976 U.S. \$16,000,000)	\$ 11,978	15,971
5½% Bonds due July 1, 1985 with annual sinking fund instalments (1977 U.S. \$22,500,000; 1976 U.S. \$25,000,000)	22,460	24,955
	\$ 34,438	40,926

<i>(Thousands of dollars)</i>	1977	1976
Promissory Notes:		
10½% Promissory Notes due December 15, 1992 with annual principal payments commencing December 15, 1983 (U.S. \$30,000,000)	\$ 32,387	—
11½% Promissory Notes due December 15, 1992 with annual principal payments commencing December 15, 1983	12,000	—
	\$ 44,387	—

In connection with the sulphite mill modification project (note 9), the company has agreed to issue by December 31, 1978 further 10½% and 11½% Promissory Notes aggregating U. S. \$20,000,000 and Cdn. \$8,000,000. In connection with the issue of the Promissory Notes, which are unsecured, the trust deed relating to the bonds previously designated as 6½% and 5½% First Mortgage and Collateral Trust Bonds was amended to provide that they be redesignated as 6½% Bonds and 5½% Bonds respectively, be unsecured and rank equally with the Promissory Notes, and to require that bank loans be unsecured. No change was made in the repayment terms and interest rates.

The Province of British Columbia has unconditionally guaranteed the payment of principal and interest on the Bonds. The Promissory Notes are not so guaranteed.

Principal payments required on long term debt during the next five years are \$7,113,000 in each of the years 1978 to 1980, \$8,207,000 in 1981 and \$3,830,000 in 1982.

6. Pensions

The company's pension plans were fully funded at December 31, 1977.

7. Share capital

<i>(Thousands of dollars)</i>	1977	1976
Non-Voting Shares without par value. Authorized 60,000 shares; issued 39,750 shares	\$ 39,750	39,750
Common Shares without par value. Authorized 24,318,119 shares; issued 12,158,153 shares (1976 — 12,154,853 shares)	29,039	29,022
	\$ 68,789	68,772

Other than with respect to voting, the Non-Voting Shares and the Common Shares are equal and carry the same rights including the right to payment of dividends and distributions of the same amount per share.

Under the company's stock option plan, 93,300 unissued Common Shares were reserved at December 31, 1977 for issue to key employees at prices equal to the market values on the dates of grant. The options are for a term of ten years and are exercisable after one year to the extent of 20% a year on a cumulative basis. At December 31, 1977, there were outstanding options, which will expire on February 25, 1984, for the purchase of 67,900 shares at the price of \$6.375 per share, and other options, which will expire on various dates in the period April 22, 1984 to November 27, 1987, for the purchase of 18,940 shares at prices ranging from \$4.325 to \$7.438. During 1977, 3,300 shares were issued for \$17,000 cash under the plan.

8. Dividend restrictions

The trust deed relating to the Bonds and the agreement relating to the Promissory Notes, in general terms, restrict dividends and certain other payments to a maximum of \$4,000,000 plus 50% of net earnings after December 31, 1976. The amount so available for dividends at December 31, 1977 was \$8,060,000.

9. Commitments

The Prince Rupert sulphite mill is currently being modified to the manufacture of kraft pulp, with completion scheduled in late 1978. The estimated cost of the modification, including related capital expenditures on the existing Prince Rupert kraft mill, is \$122,000,000

excluding capitalization of financial costs. At December 31, 1977 contractual commitments for future expenditures amounted to approximately \$25,000,000. Rental obligations under long term leases amount to approximately \$1,400,000 in each of the next five years.

10. Insurance proceeds

Insurance proceeds of \$4,562,000, net of cost, for pulp destroyed by fire, are included in other income.

11. Remuneration of directors and senior officers

The aggregate direct remuneration paid or payable to directors and senior officers amounted to \$756,000 in 1977.

12. Anti-Inflation Act

The company is subject to restraint of profit margins, dividends and compensation under the Anti-Inflation Act and has complied with all provisions of the Act to December 31, 1977.

13. Subsidiary companies

Calum Lumber Limited
Canadian Cellulose International, S. A.
Celgar Properties Limited
Celtran Equipment Limited
Colcel Properties Limited
High Arrow Limited
Pohle Lumber Co. Ltd.
Twinriver Timber Limited

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Canadian Cellulose Company, Limited as at December 31, 1977 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

Vancouver, B.C.
January 23, 1978

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1977 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Croper & Lybrand

Chartered Accountants

Five Year Review

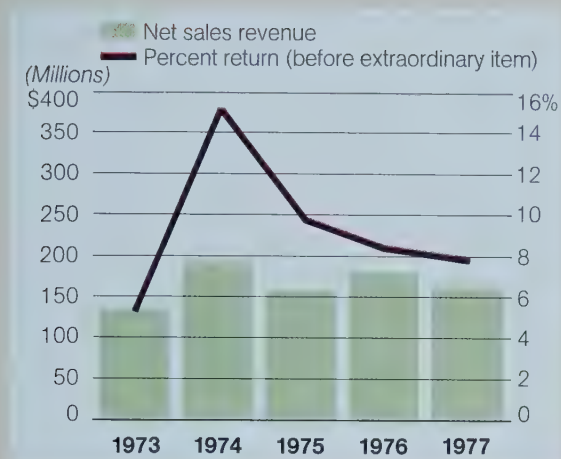
Canadian Cellulose Company, Limited and subsidiaries

	1977	1976	1975	1974	1973
Earnings (millions)					
Net sales	\$161.1	177.6	156.0	191.5	133.8
Earnings before undernoted items	23.5	29.4	29.5	54.6	13.3
Provision for income taxes	10.9	14.8	14.2	25.6	6.2
Earnings before extraordinary item	12.6	14.6	15.3	29.0	7.1
Extraordinary item	4.7	11.5	12.2	21.9	5.2
Net earnings	\$ 17.3	26.1	27.5	50.9	12.3
Per share					
Earnings before extraordinary item	\$ 1.03	1.20	1.25	2.38	.58
Net earnings	1.41	2.14	2.25	4.17	1.01
Cash flow from operations before extraordinary item	2.30	2.12	2.15	3.29	1.54
Cash flow from operations	2.68	3.06	3.15	5.08	1.97
Dividends	32¢	30½¢	30¢	5¢	—
Financial position (millions)					
Working capital	\$ 57.1	65.3	65.6	52.6	13.2
Fixed assets	347.6	272.3	276.9	263.6	252.3
Accumulated depreciation, amortization & depletion	(204.8)	(195.5)	(216.0)	(206.4)	(198.1)
Other assets	3.1	4.3	4.0	3.4	2.6
	203.0	146.4	130.5	113.2	70.0
Long term debt	79.5	41.2	47.7	54.2	60.5
Deferred income taxes	5.0	.1	.1	.1	.9
Shareholders' equity	118.5	105.1	82.7	58.9	8.6
	\$203.0	146.4	130.5	113.2	70.0
Changes in financial position (millions)					
Sources: Cash flow from operations	\$ 32.7	37.3	38.4	61.9	24.0
Issue of long term debt	44.4	—	—	—	—
Other	3.1	.1	.4	.1	42.3
	80.2	37.4	38.8	62.0	66.3
Applications: Fixed assets	77.9	27.5	14.9	14.6	9.5
Dividends	3.9	3.7	3.7	.6	—
Long term debt	6.5	6.5	6.5	7.1	7.3
Other	.1	—	.7	.3	3.7
	88.4	37.7	25.8	22.6	20.5
Increase (decrease) in working capital	\$ (8.2)	(.3)	13.0	39.4	45.8

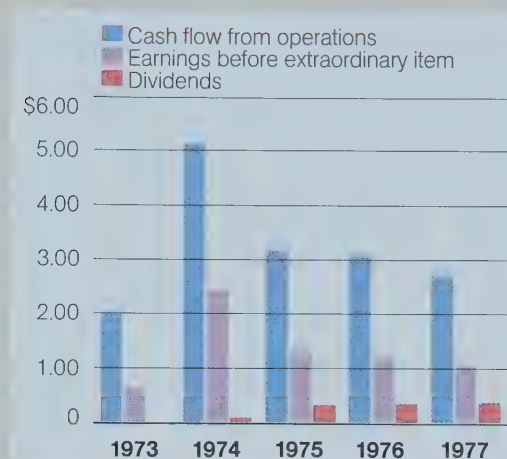
Five Years at a Glance

Canadian Cellulose Company, Limited and subsidiaries

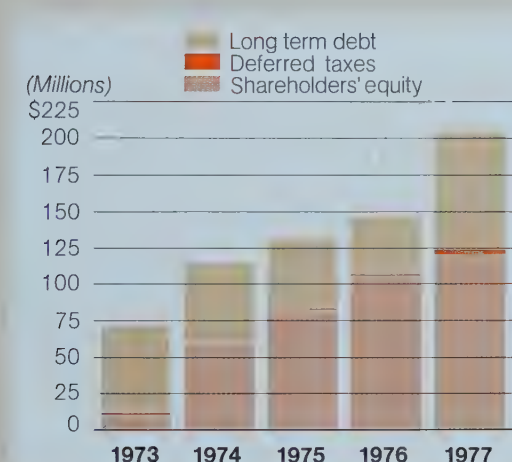
Net sales



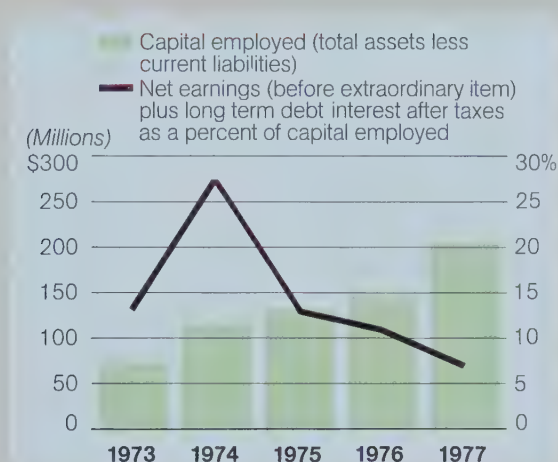
Cash flow, earnings and dividends per common share



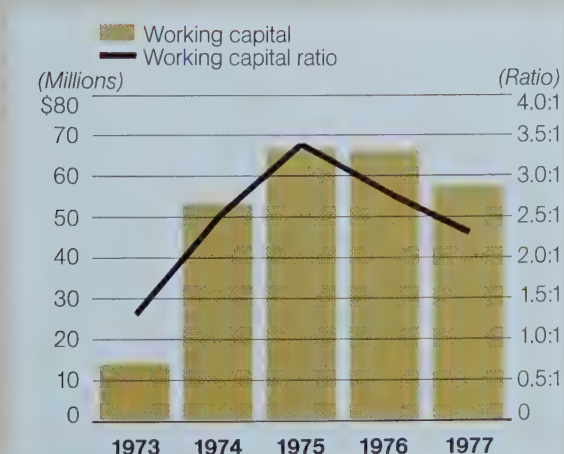
Capitalization



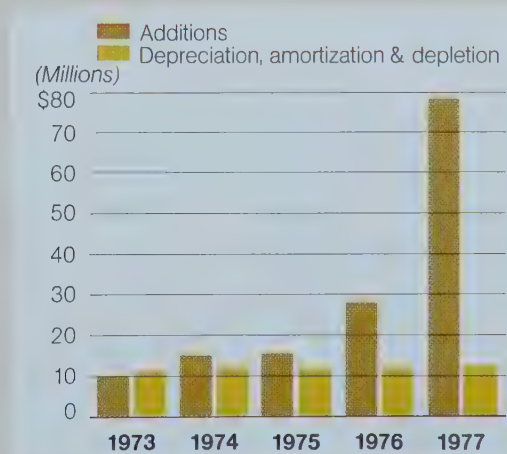
Capital employed



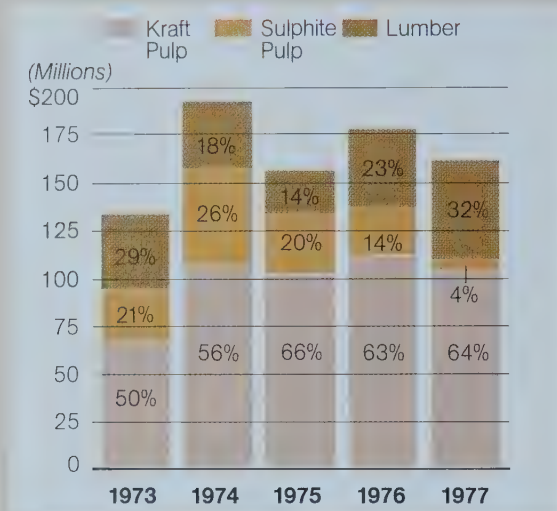
Working capital at year end



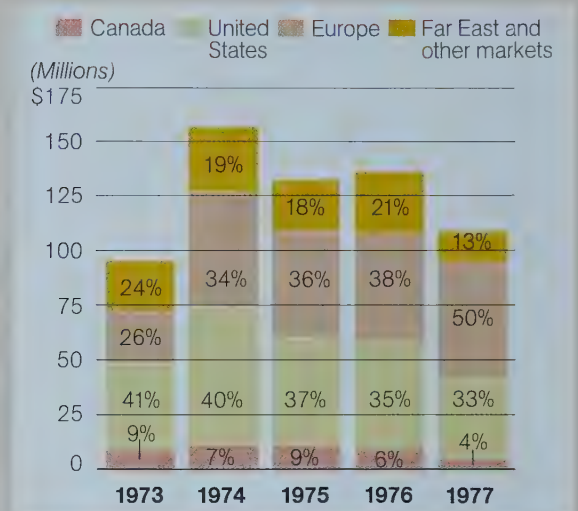
Expenditures on fixed assets



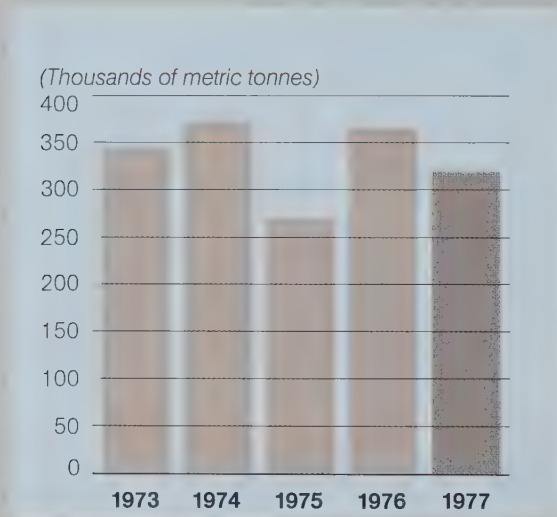
Net sales by major products



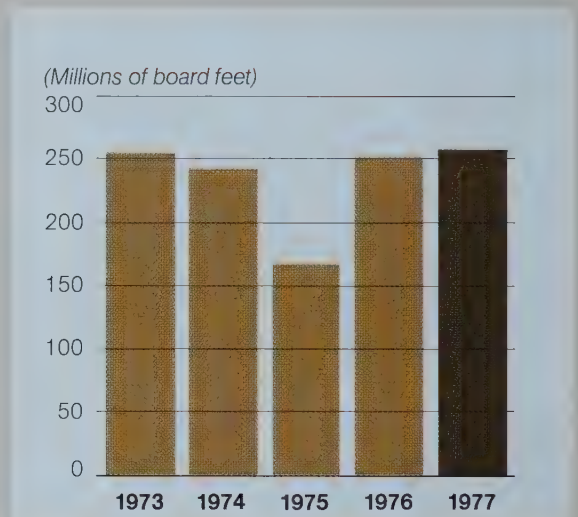
Pulp sales by market area



Kraft pulp production

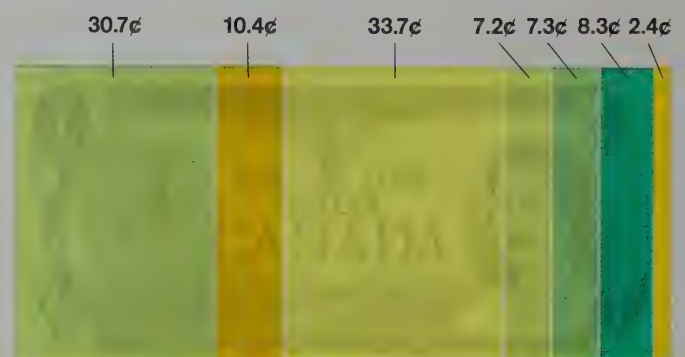


Lumber production



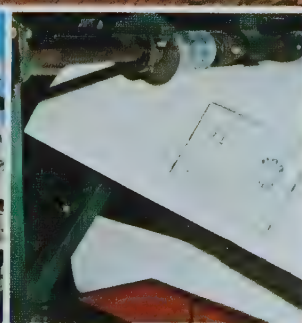
Disposition of 1977 sales dollar

30.7¢	Materials, services, interest and other costs
10.4	Payments to logging contractors
33.7	Payroll and employee benefits
7.2	Depreciation
7.3	Taxes
2.4¢	Property taxes
1.0¢	Stumpage and royalty
6.8¢	Income taxes
(2.9¢)	Income tax credit
8.3	Reinvested in the company
5.4¢	From operations
2.9¢	Extraordinary tax credit
2.4	Dividends to shareholders
100.0¢	

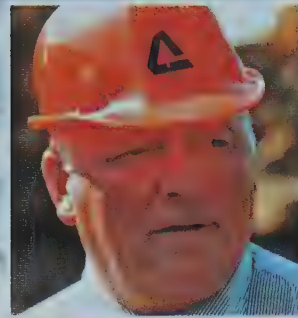




Celgar lumber and Skeena pulp are among the high quality products made from the trees of forests managed by Canadian Cellulose.



Donald N. Watson



E. Bertram Berkley



Alan S. Gordon



D. Michael M. Goldie



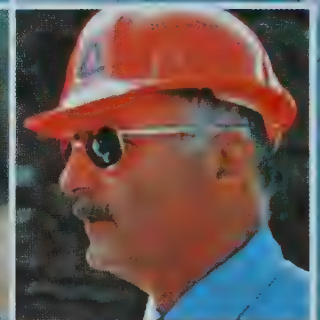
Ronald M. Gross



Charles C. Locke



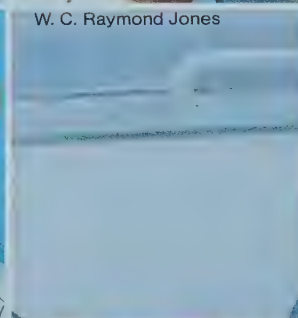
W. C. Raymond Jones



Max Litvine



Ira D. Wallach



Ray G. Williston



John H. Spicer



Corporate Information

Canadian Cellulose Company, Limited and subsidiaries

BOARD OF DIRECTORS

Donald N. Watson*[†]

Chairman, Canadian Cellulose Company, Limited, Vancouver

E. Bertram Berkley†

Chairman and President, Tension Envelope Corporation, Kansas City

D. Michael M. Goldie, Q.C.*

Partner, Russell & DuMoulin, Vancouver

Alan S. Gordon*

Consultant, Merrill Lynch, Royal Securities Limited, Montreal

Ronald M. Gross

President and Chief Executive Officer, Canadian Cellulose Company, Limited, Vancouver

W. C. Raymond Jones †

Consultant, Vancouver

Max Litvine

Managing Director, Compagnie Bruxelles Lambert, Brussels

Charles C. Locke, Q.C.*

Partner, Ladner Downs, Vancouver

John H. Spicer†

Corporate Vice-President, Canadian National Railways, Montreal

Ira D. Wallach*

Chairman and Chief Executive Officer, Gottesman & Company, Inc. and Central National Corporation, New York

Ray G. Williston†

Chairman and President, British Columbia Cellulose Company, Victoria

OFFICERS

Donald N. Watson

Chairman

Ronald M. Gross

President and Chief Executive Officer

Herschell F. Huff

Senior Vice President, Pulp

Gordon R. McLachlin

Senior Vice President, Logging and Lumber

Roy W. Murphy

Senior Vice President, Administration

Orjan Burchardt

Vice President, Pulp Manufacturing

Roger J. Duncan

Vice President, General Counsel

Clive B. Symons

Vice President, Treasurer

William H. Vaughan

Vice President, Pulp Marketing

Alan K. Wilkinson

Secretary

* Member of Executive Committee — Chairman, Charles C. Locke, Q.C.

† Member of Audit Committee — Chairman, E. Bertram Berkley

¹ Effective March 1, 1978 Mr. Watson will also become President and Chief Executive Officer succeeding Mr. Gross, who has resigned as an officer effective that date.

OPERATIONS

John N. Babcock

Manager, Kitwanga Lumber Operations

Robert E. Davis

Manager, Northern Lumber Operations

G. C. Dinning

Manager, Interior Lumber Operations

Jack W. Kreut

General Manager, Northern Pulp Operations

G. Edward Lloyd

Manager, Northern Woods Operations

H. E. Roberts

Manager, Interior Woods Operations

R. W. Sweeney

General Manager, Interior Pulp Operations

CORPORATE MANAGEMENT

A. V. (Bill) Backman

Chief Forester

Richard A. Commerford

Corporate Controller

C. J. Neil Neufeld

Director, Personnel Administration

Harry R. Papushka

Director, Supply and Distribution

Samuel H. Smillie

Director, Labour Relations

Robert E. Swenarchuk

Director, Public Relations

W. Frederick Waldie

General Manager, Forestry and Logging

CORPORATE DATA

Share Transfer Agent and Registrar

Montreal Trust Company,
466 Howe Street, Vancouver, B.C. V6C 2A8
and branches in Toronto and Montreal

Share Listings

Montreal, Toronto and Vancouver Stock
Exchanges

Auditors

Coopers & Lybrand,
28th Floor, 1055 West Georgia Street
Vancouver, B.C. V6E 3R2

Principal Subsidiary and Affiliated Companies

Babine Forest Products Limited (24% owned)
Canadian Cellulose International, S.A.
Celgar Properties Limited
Celtran Equipment Limited
High Arrow Limited
Pohle Lumber Co. Ltd.
Twinriver Timber Limited

PLANTS AND OFFICES

Corporate Office

1200-1111 West Hastings Street,
Vancouver, B.C. V6E 2K2

Pulp Marketing Offices

Montreal, P.Q., Vancouver, B.C.,
Brussels, Belgium

Kraft Pulp Mills

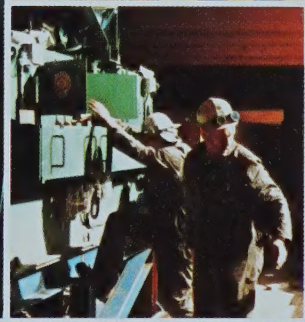
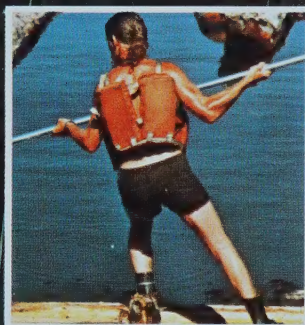
Castlegar, B.C., Prince Rupert, B.C.

Lumber Mills

Castlegar, B.C., Kitwanga, B.C., Terrace, B.C.

Woods Operations

Nakusp, B.C., Terrace, B.C.



Improved utilization of the forest resource is one benefit of the company's investment in a new smallwood sawmill at Castlegar.



Canadian Cellulose Company, Limited

1200-1111 West Hastings Street, Vancouver, B.C. V6E 2K2

LITHO'D IN CANADA